No. 02-80

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

MID-ISLAND HOSPITAL, INC. and OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF MID-ISLAND HOSPITAL, INC.,

Petitioners,

—v.—

EMPIRE BLUE CROSS AND BLUE SHIELD,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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COUNTER STATEMENT OF QUESTION PRESENTED

Whether the Second Circuit Court of Appeals properly affirmed the district court's decision affirming the bankruptcy court's decision granting Respondent's motion for summary judgment dismissing Petitioners' claim for interest and holding that Petitioners were not entitled to interest under settled New York law.

PARTIES TO THE PROCEEDING

The petition correctly names the parties to the proceeding.

STATEMENT PURSUANT TO RULE 29.6

Empire Blue Cross and Blue Shield ("Empire") states that there is no parent or publicly held company owning 10% or more of Empire's stock.

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PERTINENT STATUTORY PROVISIONS

The statutory provisions involved with respect to Petitioners' claim against Empire are 11 U.S.C. § 541(a)(6) (2002), and 10 NYCRR § 91.4(i) (2002). These statutes have been set forth in full in the Appendix hereto.

COUNTER STATEMENT OF THE CASE

New York law requires hospitals, like Mid-Island Hospital, Inc. ("Mid-Island"), to make certain payments into insurance pools ("Pools") that the State of New York ("State") maintains, among other things, to fund excess liability insurance to providers of emergency care. (Pet., App. A at 2a.) A default by a hospital on its obligation to the Pools results in the mandatory withholding of 10% of money due a hospital by all major third-party payors, such as Empire, until such time as the default is cured. 10 NYCRR § 91.4(i) (2002) ("Withholding Regulation"). The Withholding Regulation does not authorize, direct, or require the third-party payor to segregate, invest, pay, or accrue interest on the withheld amounts. (Pet., App. A at 9a.)

In December 1989, after Mid-Island's default on its obligation to the Pools and in accordance with the Withholding Regulation, the State directed Empire to begin withholding 10% of its payments to Mid-Island for treating Empire's subscribers ("Withholdings"). (Pet., App. A at 3a.) *See* 10 NYCRR § 91.4(i) (2002).

Mid-Island remained in default for the next eight years. Accordingly, as directed by the State, Empire withheld 10% of its payments to Mid-Island. Shortly after filing its chapter 11 petition in June 1997, Mid-Island sought turnover of the Withholdings. In January 1998, pursuant to a settlement agreement among Mid-Island, the State, the Office of the United States Trustee, and the Official

Committee of Unsecured Creditors ("Committee") that was So-Ordered by Honorable Marvin A. Holland, United States Bankruptcy Judge, on December 18, 1997, Empire wired all amounts withheld—$4,379,597.52—to Mid-Island's counsel. (Pet., App. A at 4a.) Neither the settlement agreement, nor the order approving the settlement agreement required the payment of interest to Mid-Island. Thereafter, Mid-Island agreed to pay the State $2,222,000 in settlement of the State's pre-petition claims. (Pet., App. A at 4a.)

It is undisputed that during this eight-year period, Mid-Island never requested that Empire segregate the Withholdings, place the withheld funds in an interest bearing account, or otherwise invest the withheld funds. (Pet., App. A at 9a.)

It was further undisputed below that the State has ***never*** directed a third-party payor to segregate, invest, accrue, or pay interest on monies being retained for the State's benefit pursuant to the Withholding Regulation. Rather, in those instances where a hospital has cured its payment obligation default and Empire or another third party payor has been directed by the State to pay monies to a hospital that were being held pursuant to the Withholding Regulation, the monies have been paid to the hospital without interest. This is fully consistent with the payment triggering event: when a hospital cures its default by making payment of all delinquent amounts, it does not pay the State interest on account of the amounts owed. Were it otherwise—if the State charged the hospitals no interest on delinquent amounts but directed third-party payors to pay interest to the hospitals on withheld monies—hospitals would have an incentive to be delinquent in paying their obligations.

Either as an afterthought, or an attempt to get something for nothing, approximately nine months after the

settlement with the State, Mid-Island and the Committee (collectively, "Petitioners") commenced the underlying adversary proceeding in the United States Bankruptcy Court for the Eastern District of New York. Asserting purported causes of action under both the Bankruptcy Code and New York law, the gravamen of their Complaint was that Empire owed them interest on the monies it previously withheld pursuant to the Withholding Regulation. (Pet., App. A at 4a.)

Following extensive briefing and argument, the bankruptcy court rejected Petitioners' claims and granted Empire's motion for summary judgment. (Pet., App. A at 5a.) The bankruptcy court found that Mid-Island had no right to interest under New York law or pursuant to any contract or other agreement with Empire. (Pet., App. A at 5a.) The bankruptcy court also found that any interest allegedly earned on the monies retained by Empire was not property of Mid-Island's bankruptcy estate or subject to a turnover proceeding under the Bankruptcy Code. (Pet., App. A at 5a.)

On appeal, the district court affirmed. (Pet., App. B at 21a.) Among other things, the district court found that the monies retained by Empire at the State's direction were not property of Mid-Island's estate at the time of commencement of the bankruptcy case. (Pet., App. B at 18a.) The district court reasoned that at the commencement of the bankruptcy case, Mid-Island was not entitled to the use or possession of the monies being retained by Empire under the Withholding Regulation—the purpose of which was to provide a source of funds for the State to access in the event Mid-Island never paid its delinquent obligations to the State. (Pet., App. B at 17a-18a.) Accordingly, the district court reasoned that any interest allegedly earned on the retained monies was also not property of the bankruptcy estate. (Pet., App. B at 19a.)

The district court did not reach the issue of whether Mid-Island had any right to interest under New York law.

On appeal, the United States Court of Appeals for the Second Circuit ("Second Circuit") affirmed. (Pet., App. A at 12a.) In its opinion, dated January 15, 2002, the Second Circuit observed that "as of the date Mid-Island filed its reorganization petition, its right to the withheld funds was contingent on satisfying its obligations to the excess liability pool. Not having made the required payments, Mid-Island had no current possessory interest in the funds when it filed its reorganization petition." (Pet., App. A at 7a.) Instead, Mid-Island "had a limited, contingent interest in the withheld funds when it filed its petition for reorganization." (Pet., App. A at 2a.) Based on this finding, the Second Circuit concluded that "the [Petitioners'] 'speculative' and 'intangible' interest in the funds, which was contingent on the satisfaction of its obligations to the State, was property of the estate." (Pet., App. A at 7a.)

More importantly, in turning to the central issue of whether Mid-Island's contingent interest in the Withholdings gave it a right to profits from or interest on the Withholdings, the Second Circuit correctly looked to New York law. On that issue, the Second Circuit held that under settled New York law, Empire "had no obligation to pay Mid-Island interest or invest the funds for Mid-Island's benefit. . ." (Pet., App. A at 2a.) Accordingly, the Second Circuit held that Mid-Island had no right to any such interest. Further, the Second Circuit held that "[n]o separate analysis is required for section 541(a)(6) because it conveys no greater right than Mid-Island would have under state law." (Pet., App. A at 8a.)

REASONS FOR DENYING THE WRIT

I.

THE SECOND CIRCUIT CORRECTLY HELD THAT BECAUSE MID-ISLAND HAD NO RIGHT UNDER NEW YORK LAW TO INTEREST ON THE WITHHOLDINGS, THE FILING OF ITS BANKRUPTCY CASE COULD NOT CREATE SUCH A RIGHT UNDER SECTION 541(a)(6)

Petitioners argue that the Second Circuit "grossly misinterpreted" Section 541(a)(6) of the Bankruptcy Code. (Pet. at 11.) Petitioners suggest that it is "paradoxical" for the court below to find that the Withholdings was property of the estate, yet not find that interest, if any, earned on the Withholdings is also property of the estate. (Pet. at *i.*) Petitioners' belief that the Second Circuit's decision exhibits inexplicable or contradictory conclusions arises only because Petitioners misunderstand the scope of "property of the estate" and seek to endow the Bankruptcy Code with the power to create property rights where such rights simply do not exist. In concept, and in a context other than the one at bar, interest may be a property right, but only to the extent that state law creates such a right. The Second Circuit correctly concluded that based upon the undisputed facts of this case, a right to interest never arose under New York law. Accordingly, no analysis of Section 541(a)(6) was required because there simply was no property right. Consequently, the conclusion of the Second Circuit is a paradox, but only to the extent that by paradox one means a seemingly contradictory statement that nonetheless is true.

The obvious flaw in Petitioners' argument stems from a basic misunderstanding of the concept of property of the estate under the Bankruptcy Code. Generally, Section

541 of the Bankruptcy Code provides that the filing of a petition for relief under Title 11 of the United States Code "creates an estate." Such estate is comprised of certain types of property described and defined in Sections 541(a)(1) through (7) in which the debtor has a legal or equitable interest.

However, "whereas federal law instructs us that [property] ***may*** constitute property of [the debtor's] estate, state law determines whether [the debtor's] interest in the [property] is sufficient to confer on the estate a property right in the [property]." *In re Crysen/Montenay Energy Co.*, 902 F.2d 1098, 1101 (2d Cir. 1990) (emphasis added). *See also, In re Prudential Lines Inc.*, 928 F.2d 565, 569 (2d Cir. 1991), *cert. denied, PSS S.S. Co., Inc. v. Official Committee of Unsecured Creditors*, 502 U.S. 821 (1991) (Nature and extent of debtor's interests in property is determined by applicable nonbankruptcy law, but whether that interest is included in property of debtor's estate is determined by bankruptcy law). All other circuits that have analyzed this precise issue have similarly held. *See, e.g., In re Pettit*, 217 F.3d 1072, 1078 (9th Cir. 2000); *In re Marrs-Winn Co., Inc.*, 103 F.3d 584, 591 (7th Cir. 1996); *In re Harrell*, 73 F.3d 218, 219 (9th Cir. 1996); *Bavely v. IRS (In re Terwilligers Catering Plus, Inc.)*, 911 F.2d 1168, 1172 (6th Cir. 1990) *(quoting N.S. Garrott & Sons v. Union Planters Nat'l Bank of Memphis (In re N.S. Garrott & Sons)*, 772 F.2d 462, 466 (8th Cir. 1985); *Koch Refining v. Farmers Union Cent. Exchange, Inc.*, 831 F.2d 1339, 1343 (7th Cir. 1987), *cert. denied*, 485 U.S. 906 (1987).

In essence, Petitioners appear to be arguing that Section 541(a)(6) creates some kind of *sui generis* bankruptcy property right in interest that is independent of state law and that Mid-Island's entitlement to interest on the Withholdings arises as a result of this right. This argument flies in the face of established Supreme Court

precedent in *Butner v. United States*, 440 U.S. 48 (1979) and its progeny. In *Butner*, this Court held that "[p]roperty interests are created and defined by state law." *Id.* at 55. This concept is basic to bankruptcy law. The "nature and extent of debtor's interest in property is determined by state law, with the estate having no greater rights in property than those held by debtor prior to bankruptcy." *In re Coupon Clearing Service, Inc.*, 113 F.3d 1091 (9th Cir. 1997). *E.g., In re N.S. Garrott & Sons*, 772 F. 2d 462, 465-66 (8th Cir. 1985); *In re TTS, Inc.*, 158 B.R. 583, 585 (Bankr. D. Del. 1993) (Section 541(a) of the Bankruptcy Code "does not give the debtor greater rights to property than the debtor had before filing for Chapter 11."); *Musso v. State Higher Educ. Svcs. Corp. (In re Royal Bus Sch. Inc.)*, 157 B.R. 932, 941 (Bankr. E.D.N.Y. 1993) ("§ 541(a) was not designed to enlarge the debtor's rights against others beyond those existing at the commencement of the case") (*citing TTS*, 158 B.R. at 587)); *S. Rep. No. 95-989, 95th Cong., 2d Sess., and H.R. Rep. No. 95-595, 95th Cong., 2d Sess. reprinted in 1978 U.S. Code Cong. & Ad. News* 5787, 5868, 6323. Simply put, "[b]ankruptcy law does not create property . . ." *Matter of Pinetree, Ltd.*, 876 F.2d 34, 36 (5th Cir. 1989).

The determination of the Second Circuit that "no separate analysis is required for Section 541(a)(6) because it conveys no greater right than Mid-Island would have under state law" (Pet., App. A at 8a) is, therefore, entirely consistent with well established bankruptcy law. Consequently, the Second Circuit correctly concluded that the key question was whether Mid-Island had a right to interest on the Withholdings under New York law as of the commencement of the bankruptcy case. In answering this question, the Second Circuit's analysis is beyond reproach:

> First [the Witholdong Regulation] does not provide either that [Mid-Island] must pay interest

> to the State or that Empire must pay interest to [Mid-Island]. Second, an Empire officer swore that Empire had not paid interest to hospitals in the past when the State directed it to release withheld funds. Third, during the entire time Empire held the funds, [Mid-Island] never demanded that Empire segregate them or place them in an interest-bearing account. Finally, no [Mid-Island] officer or employee swore that he believed there was an implicit agreement on Empire's part to pay interest. The summary judgment record supplies no basis from which a finder of fact reasonably could infer that both parties implicitly agreed to the payment of interest on the withheld funds. The withholding regulation does not require the payment of interest. There was no default on Empire's part. Thus, Empire does not owe interest on any contractual theory. (Pet., App. A. at 9a.)

It is black letter law in New York that a party seeking the payment of interest must demonstrate its entitlement (1) as a matter of statute, (2) by express or implied contractual agreement, or (3) as a result of the withholding of a payment of a definite sum of money after the time for its payment has passed. *New York State Thruway Authority v. Hurd,* 25 N.Y. 2d 150, 158, 250 N.E.2d 335, 339, 303 N.Y.S. 2d 51, 56 (1969). *See generally* 45 Am. Jur. 2d *Interest and Usury* § 20 (1999). Recognizing this, the bankruptcy court correctly framed the applicable legal standard when it stated the following during the March 17, 1999 hearing:

> My reason for the summary judgment motion is essentially that I do not see that the debtor has made out a prima facie entitlement to interest without an existing obligation to pay and a

> demand that was properly made that hadn't been complied with. Or in the alternative, which I don't think is at issue here, either a statute or a contract that requires the payment of interest.

Petitioners attempt to argue that the Second Circuit's analysis is flawed because it refused to apply Section 541(a)(6) simply misses the point: the Second Circuit plainly considered the applicability of Section 541(a)(6) and just as plainly and clearly opined that Section 541(a)(6) does not create greater rights in property than the debtor had prior to filing for bankruptcy and therefore, correctly turned its attention to state law.

The Second Circuit's decision is consistent with the decisions of every other circuit. *See, e.g., In re O'Dowd,* 233 F.3d 197, 202 (3d Cir. 2000) (while federal law defines what types of property comprise the estate, state law generally determines what interest, if any, a debtor has in property); *Americans Bankers Ins. Co. of Florida v. Maness,* 101 F.3d 358, 363 (4th Cir. 1996) (while federal law creates bankruptcy estate, state law, absent countervailing federal interest, determines whether given property falls within this federal framework); *In re Roosevelt,* 87 F.3d 311, 314 (9th Cir. 1996) (court of appeals looks to state law in determining property rights of Chapter 7 Debtor); *In re Smith,* 85 F.3d 1555, 1557 (11th Cir. 1996) (property rights of debtor in bankruptcy estate are defined by state law); *In re Oxford Development, Ltd.,* 67 F.3d 683, 685 (8th Cir. 1995) (property interests are defined by state law, and unless some federal interest requires different result, there is no reason why such interests should be analyzed differently simply because interested party is involved in bankruptcy proceeding); *In re Stat-Tech Intern. Corp.,* 47 F.3d 1054, 1057 (10th Cir. 1995) (ownership of property interests is deter-

mined, for purposes of deciding whether property is included in property of the estate, in accordance with state law); *Congress Credit Corp. v. AJC Intern, Inc.*, 42 F.3d 686, 689 (1st Cir. 1994) (courts look to state law for determination of interests in assets of bankruptcy estate); *In re Omegas Group, Inc.*, 16 F.3d 1443, 1450 (6th Cir. 1994) (existence of parties' property rights in bankruptcy depends on state law); *Matter of Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993) (question of whether interest claimed by debtor is property of the bankruptcy estate is federal question to be decided by federal law; however, courts must look to state law to determine whether and to what extent debtor has any legal or equitable interest in property as of commencement of the case); *In re Crysen/Montenay Energy Co.*, 902 F.2d 1098, 1101 (2d Cir. 1990) (although federal bankruptcy law determines outer boundary in what may constitute property of estate, state law determines nature of debtor's interest in given item); *Matter of Pinetree, Ltd.*, 876 F.2d 34, 36 (5th Cir. 1989) (bankruptcy law does not create property; rather, nature of debtor's interest in property which accrues to estate is based on non-bankruptcy law).

Here, the Petitioners had no right to interest under New York law prior to Mid-Island's filing its bankruptcy petition. Thus, because the Bankruptcy Code could not give Mid-Island greater rights to property than it had before filing for Chapter 11, and because Mid-Island had absolutely no right to interest on the Withholdings under state law, the Second Circuit correctly held that Mid-Island had no right to interest under Section 541(a)(6).

The three cases cited by Petitioners do not compel a different analysis and are easily distinguishable. Most significantly, none of the cited cases address or support

the theory that Section 541(a)(6) somehow grants special powers to a debtor. In *In re #1 Con-Struct Corp.*, 88 B.R. 376 (Bankr. S.D. Fla. 1988), the issue was whether the debtor was the bona fide beneficiary to an insurance policy under Section 541(a)(5)(C) of the Bankruptcy Code[1] when the insured had not died within 180 days after the Petition commencing the case was filed. The issue of whether the interest on the insurance proceeds was property of the estate under Section 541(a)(6) was not addressed—presumably because the insurance policy itself provided for the payment of such interest to the beneficiary along with the insurance proceeds. Similarly, the bankruptcy court in *In re Rundlett,* 136 B.R. 376 (Bankr. S.D.N.Y. 1992), was faced with the issue of whether the income from invested insurance proceeds was property of the estate under Section 541(a)(6), but was not presented with the question of whether the debtor had a right to interest on the income under state law prior to commencing the case. Finally, *In re Bentley,* 916 F.2d 431, 432 (8th Cir. 1990), merely recognized that "proceeds and profits from the sale of [property of the estate] constituted property of the bankruptcy estate" under section 541(a)(6) in a case where, as in *Rundlett,* there was no dispute that the debtor had a right to the proceeds and profits.

In sum, the Second Circuit correctly held that Mid-Island's bankruptcy petition and status as a chapter 11 debtor could not create a right to interest on the Withholdings that did not exist pre-bankruptcy. Accordingly,

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[1] Section 541(a)(5)(C) of the Bankruptcy Code provides that property of the estate includes "[a]ny interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date. . .as a beneficiary of a life insurance policy or of a death benefit plan."

because Mid-Island had no right to interest on the Withholdings prior to commencing its bankruptcy case, the filing of the case created no such right—under Section 541(a)(6) or otherwise.[2]

II.

PETITIONER'S ARGUMENT THAT THERE WERE UNDETERMINED FACTUAL ISSUES THAT SHOULD HAVE PRECLUDED THE GRANTING OF SUMMARY JUDGMENT IS WRONG AND, IN ANY EVENT, NOT A BASIS FOR GRANTING CERTIORARI

Petitioners argue that certiorari should be granted because the lower courts never determined whether, in fact, Empire earned any interest on the Withholdings. This issue is irrelevant. The Second Circuit correctly

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[2] Grasping for straws, Petitioners conclusorily argue—in a single sentence in their Petition—that the "inconsistency" between the Second Circuit's decision and the district court's decision warrants review by this Court. This argument misunderstands the concept of *de novo* review by an appellate court. As the Second Circuit stated in its decision, "[w]e review *de novo* the district court's determination that a given item is or is not property of the estate." (Pet., App. A at p. 6a., (citing *In re Renshaw*, 222 F.3d 82, 86 (2d Cir. 2000))). Furthermore, the Second Circuit was "free to affirm a district court decision on any grounds for which there is a record sufficient to permit conclusions of law, even grounds not relied upon by the district court." *Railway Labor Executives' Ass'n v. Staten Island R.R.*, 792 F.2d 7, 12 (2d Cir. 1986), *cert. denied*, 479 U.S. 1054 (1987). *See also DeBruce Grain, Inc. v. Union Pacific R. Co.*, 149 F.3d 787, 789-90 (8th Cir. 1998) (court of appeals may affirm district court on any basis supported by the record); *Orner v. Shalala*, 30 F.3d 1307, 1310 (10th Cir. 1994) (court of appeals may affirm challenged decisions of district court on alternative grounds, so long as record is sufficient to permit conclusions of law); *Heimbach v. Chu*, 744 F.2d 11, 13 (2d Cir. 1984), *cert. denied*, 470 U.S. 1084 (1985). Here, the Second Circuit's decision was amply supported by the record.

held that Mid-Island was not entitled to any such interest as a matter of law. As such, it is irrelevant whether interest was or was not actually earned.

Moreover, as stated in Rule 10 of the Supreme Court Rules, "[a] petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings. . ." This is precisely what Petitioners are arguing herein.

CONCLUSION

For all of the foregoing reasons, Respondent respectfully requests that this Honorable Court deny the Petition.

Respectfully submitted,

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